Introduction to Islamic Finance
Its Concepts, Models, Growth and Opportunities

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The Islamic Finance Markets - Highlights

- Estimated growth rate of 15-20% per annum.
- Islamic assets account for approximately 1% of global banking assets at $450 billion and expectations to reach $1 trillion by 2010.
- According to a survey by the Economist Intelligence Unit
  - 60% of respondents expected a substantive increase in demand for Islamic products
  - 80% of respondents expect to increase their investment in the region over the next 3 years.

The Islamic Finance Markets – Highlights

- Leading Islamic Finance centres : Bahrain, Dubai, Kuala Lumpur, London
- More than 300 Islamic financial institutions operate worldwide in some 75 countries
- Islamic banks not confined to Muslim countries but spread over Europe, the United States, the Far East and the Middle East

Why the Sudden Interest?

- In the aftermath of September 11, 2001, there has been a flight of Islamic Capital from the USA to Europe, Asia and also back to the Middle East
- High oil prices that have created significant liquidity/wealth in the Middle East

Principles of Islamic Finance

Main principles of Islamic finance:

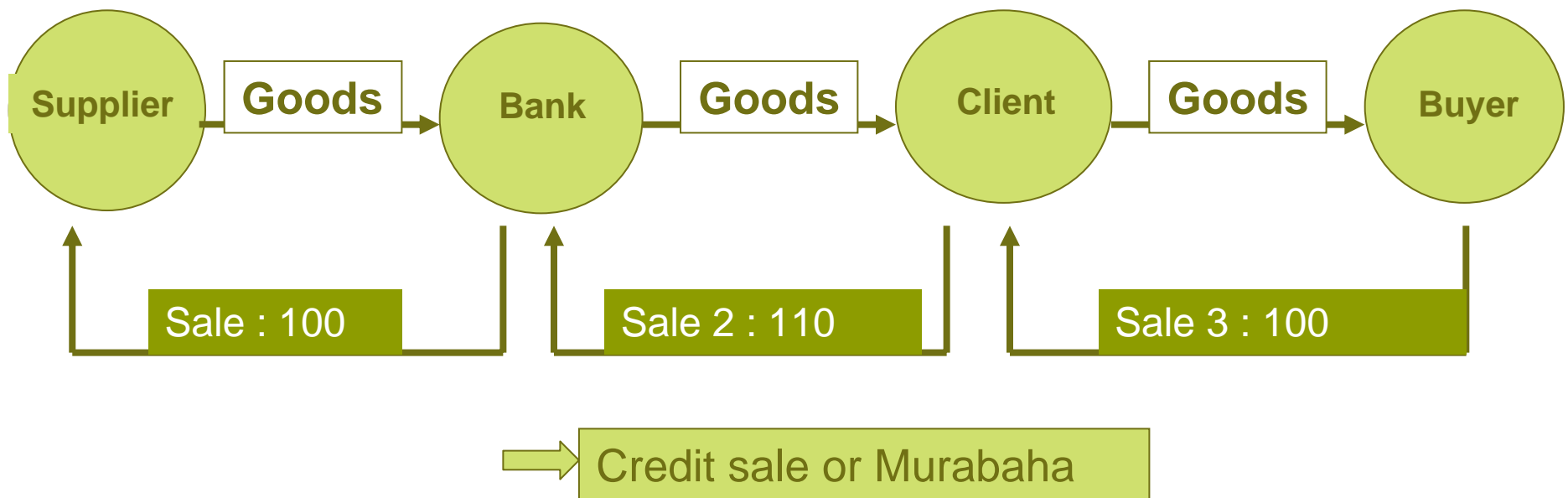
1 Prohibition of RIBA (interest): No receipt of interest

2 Prohibition of activities with elements of GHARAR (uncertainty): excessive speculation is prohibited. Gambling, derivatives

3 Prohibition to invest in certain sectors- “haram” items:

- Alcohol/drugs
- Weapons/defense
- Adult entertainment
- Pig related industry
- Conventional financial services (banks, insurance)

4 Transactions should be backed by a tangible asset

Illustration of Basic Differences between Islamic and Conventional Modes of Finance

Major Contracts/Products used in Islamic Banking

Murabaha: Buying & Selling

Mudaraba: Investment management

Musharaka: Partnership

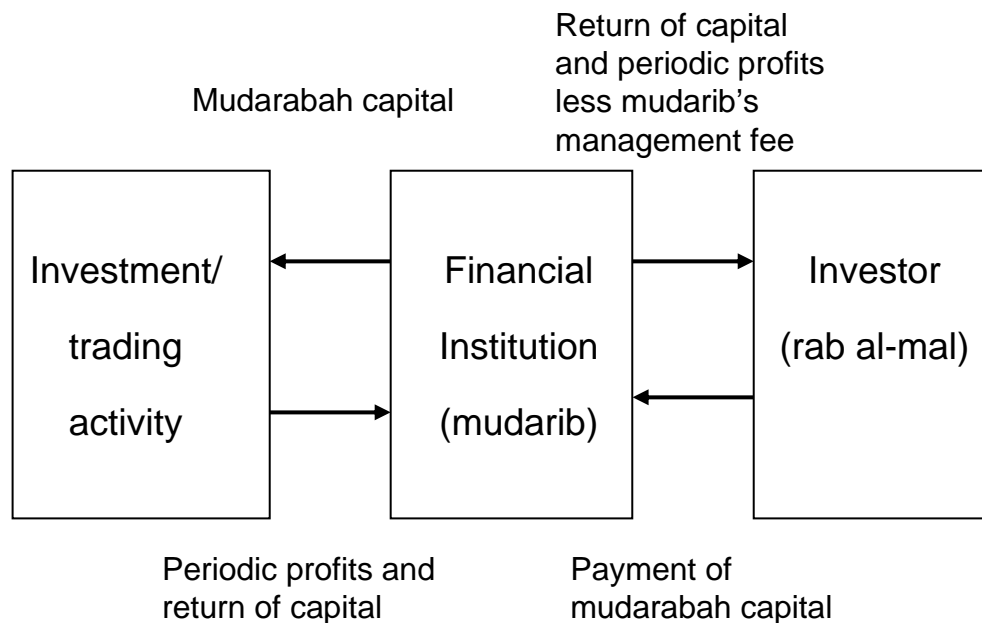
Ijarah: Leasing

Sukuk: Islamic bonds

Takaful: Islamic insurance

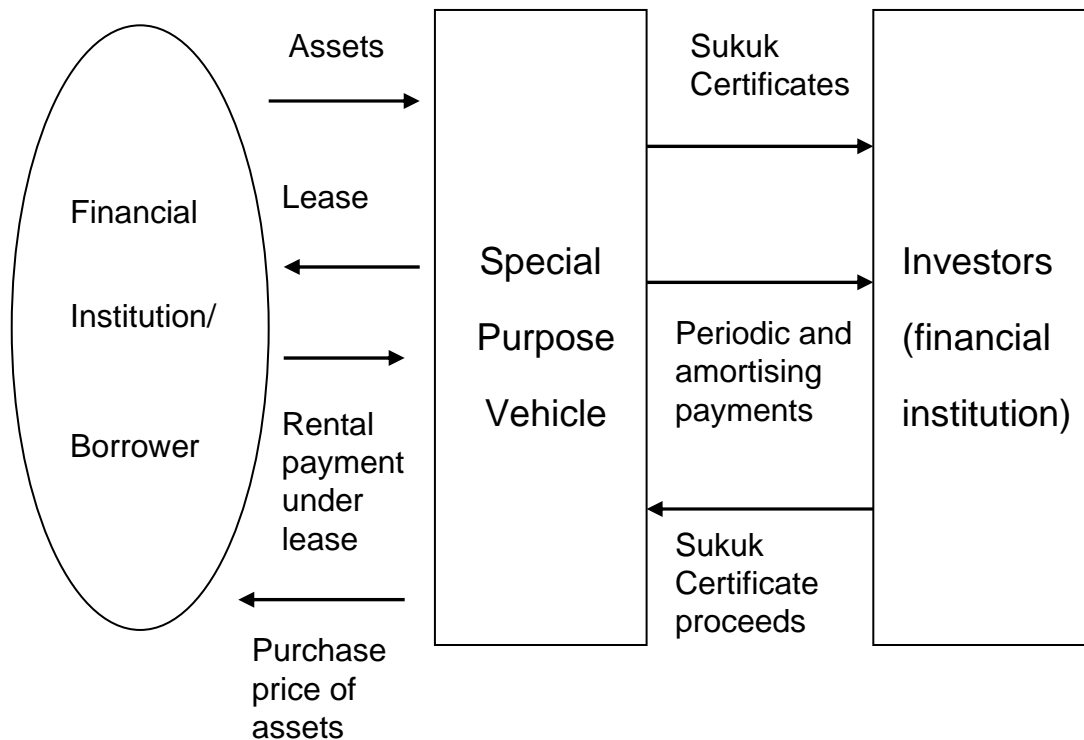
Wakalah: Agency

Istisna': Contract of works

Mudaraba

Investors provide the financial institutions with capital to fund a specified enterprise

The financial institution does not contribute capital but investment management capabilities only

Similar to discretionary asset management

Sukuk

Sukuk essentially amounts to commercial paper that provides the subscriber with ownership or part ownership in the underlying asset: Asset backed note

⇨ Securitisation

Sharia board

One distinct feature of the modern Islamic banking is the role of the Sharia boards

=> boards made up of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of Sharia compliant products, which have to approve all transactions:

- Sharia board ensures that investments structures are in line with Sharia
- Sharia board has the responsibility of laying down the underpinning Sharia principles and rules that the institution should adhere to

What has Luxembourg to offer in terms of sharia compliant funds?

- Long standing fund market underpinned by highly qualified service providers, fund promotors and accessible regulator
- Free distribution of UCITS funds across Europe based on EU-passport
- Flexible tax and regulatory framework catering for sharia compliant product
- Strong private banking sector
- Luxembourg fund product is a strong brand across Europe and Asia
- Neutral (political) profile
- Multilingual workforce

Questions

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